**Before the**
**FEDERAL COMMUNICATIONS COMMISSION**

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|---|---|---|
| **In the Matter of** | | |
| **Long-Term Telephone Number Portability Tariff Filings** | ) | **CC Docket No. 99-35** |
| | ) | |
| **U S WEST Tariff F.C.C. No. 2** | ) | **Transmittal Nos. 965, 975** |

# COMMENTS OF THE MINNESOTA DEPARTMENT OF PUBLIC SERVICE ON DIRECT CASE

Pursuant to the March 25, 1999, Order Designating Issues for Investigation (Designation Order), the Minnesota Department of Public Service (MNDPS) hereby files its comments on the direct case filed by U S WEST Communications, Inc. (U S WEST) concerning the lawfulness of its long-term local number portability (LNP) query and LNP end-user surcharge tariff filings.

U S WEST has failed to demonstrate that its tariff filings meet the requirements established by the FCC's Third Report and Order, Telephone Number Portability, CC Docket No. 95-116, FCC 98-82 (released May 12, 1998) (Third Report and Order), and the Common Carrier Bureau's Memorandum Opinion and Order, Telephone Number Portability Cost Classification Proceeding, CC Docket No. 95-116, RM 8535 (released December 14, 1998) (LNP Cost Classification Order). U S WEST's direct case does not adequately show that costs included for LNP recovery meet the two-part test established by the LNP Cost Classification Order, and includes significant costs generated by its failure to provide Competitive Local Exchange Companies (CLECs) with non-discriminatory access to its OSS systems.

A portion of the incremental costs of providing long-term number portability will jointly support non-LNP functions. In allocating such joint costs to LNP and non-LNP functions, the Commission determined that only "that portion of a carrier's joint costs that is demonstrably an incremental cost carriers incur in the provision of long-term in number portability" should be treated as an incremental cost of providing LNP. Third Report and Order at ¶ 73. The Common Carrier Bureau's Cost Classification Order further stated that an allocation of incremental costs between joint functions requires that "incumbent LECs subtract the costs of an item without the telephone number portability functionality from the total costs of that item with the telephone number portability functionality." Cost Classification Order at ¶ 23. With respect to its switching and network costs, the Designation Order specifically required U S WEST to "demonstrate its total network switching and signaling costs with and without long-term number portability." Designation Order at ¶ 9. U S WEST's only response is an assertion that its "cost model did not produce double recovery." U S WEST Direct Case at p. 12. U S WEST has provided insufficient evidence to demonstrate that it appropriately calculated its incremental costs of switching and signaling as required by the Cost Classification Order, and as specifically requested by the Designation Order.

In its Designation Order, the Common Carrier Bureau raised the question of whether U S WEST's costs for implementing LNP are substantially higher than those of other RBOCs because its network is less efficient. The Designation Order notes that U S WEST has claimed significant costs for "service delivery" which includes personnel training for negotiating, preparing and correcting service orders for ported numbers, and hiring additional personnel. Designation Order at ¶12-13. The MNDPS believes much of U S WEST's service delivery costs result from the inefficiencies of U S WEST's operation support system interfaces, and U S WEST's failure to provide non-discriminatory access to its OSS systems, and should be disallowed.

In a cost proceeding before the Minnesota Public Utilities Commission (MNPUC) to determine the total element long run incremental cost of unbundled network elements for U S WEST, the MNDPS reviewed the process U S WEST has put in place for handling CLEC orders, including its OSS interfaces. (In the Matter of a Generic Investigation of U S WEST Communications, Inc.'s Cost of Providing Interconnection and Unbundled Network Elements, Docket No. P442,5321,3167,466,421/CI-96-1540.) As part of its review, the MNDPS witnessed two demonstrations of U S WEST's interface, as well as a demonstration of its internal operations support systems. From this review and other evidence provided in the case, the MNDPS concluded that U S WEST's interfaces failed to provide CLECs with non-discriminatory access to its OSS systems. The MNDPS recommended denying U S WEST any cost recovery for developing its interfaces and upgrading its OSS systems until it demonstrated that its interfaces provide non-discriminatory access, as required by the Telecommunications Act of 1996, and the FCC's First Interconnection Order. In its May 3, 1999 Order, the MNPUC adopted the MNDPS recommendation to "deny any U S WEST cost recovery of operation support system (OSS) costs until U S WEST provides CLECs non-discriminatory access to OSS interfaces and provides reliable cost support for its proposed rates." (ORDER RESOLVING COST METHODOLOGY issued May 3, 1999, In the Matter of a Generic Investigation of U S WEST Communications, Inc.'s Cost of Providing Interconnection and Unbundled Network Elements, Docket No. P442,5321,3167,466,421/CI-96-1540.)

U S WEST has failed to provide its competitors with non-discriminatory access to its OSS, and in this proceeding it seeks to recover the higher costs its anti-competitive behavior has generated from consumers through its LNP end-user charge. The process U S WEST has in place to handle CLEC orders requires high levels of manual intervention in order processing and high personnel costs and, consequently, accounts for the high expenditures for "Service Delivery Costs" contained in its LNP tariffs.

U S WEST has two electronic interfaces, the Interconnection Mediated Access (IMA) interface using a web-based technology, and an Electronic Data Interchange (EDI) interface. With either interface, an order placed by a CLEC is sent to U S WEST's Interconnection Service Center. At the Interconnection Service Center, each and every order is reviewed by a U S WEST service representative and, in all but a few cases, orders are completely retyped for entry into U S WEST's legacy systems. The high level of manual intervention increases the risk of error, slows the processing of orders, results in discriminatory access, and raises the cost of serving customers.

The FCC has recognized the importance of adequate electronic flow-through of orders to competitive entry. In its December 24, 1997 Order on BellSouth Corporation's application to provide InterLATA service in South Carolina, the FCC stated that "access to OSS functions must be offered such that competing carriers are able to perform OSS functions in "substantially the same time and manner" as the BOC." (Memorandum Opinion and Order, In the Matter of Application of BellSouth Corporation Pursuant to Section 271 of the Communications Act of 1934, as amended, to Provide In-Region, InterLATA Services in South Carolina, CC Docket No. 97-208, released December 24, 1997.) CLECs submitting an order to U S WEST will have every order reviewed by a U S WEST service representative, and in most cases the order will be retyped for entry into U S WEST's legacy systems. This manual review drives up the cost of order processing. For example, the lack of any electronic flow-through in this first step of processing an order increased the non-recurring cost for an unbundled loop by over 50 percent.

The MNPUC recognized that U S WEST's anti-competitive behavior increased the cost of order processing and rejected U S WEST's request to recover those costs from its competitors. The Commission should likewise reject U S WEST's attempts to recover the costs of its anti-competitive systems from end-users through the LNP end-user charge. Requiring end-users to pay for U S WEST's anti-competitive behavior does not further the implementation of competition, and is not in the public interest.

U S WEST has also failed to demonstrate that its service delivery costs comply with the LNP Cost Classification Order's two-part test. The Commission's Third Report and Order very narrowly defined the LNP costs eligible for recovery as the "costs carriers incur specifically in the provision of number portability services, such as for the querying of calls and the porting of telephone numbers from one carrier to another." Third Report and Order at ¶ 72. The LNP Cost Classification Order interpreted the phrase "porting telephone numbers from one carrier to another" as, "referring only to the systems for uploading and downloading LRN information to and from the regional Number Portability Administration Centers (NPACs) and for transmitting porting orders between carriers." LNP Cost Classification Order at ¶ 14. In the LNP Cost Classification Order, the Common Carrier Bureau established that a carrier must demonstrate that "costs: (1) would not have been incurred by the carrier "but for" the implementation of number portability; and (2) were incurred "for the provision of" number portability service", and specifically rejected costs that are an incidental consequence of providing number portability." LNP Cost Classification Order at ¶ 10.

In Transmittal No. 965, U S WEST states that it has included the cost of negotiating service orders with end user customers who wish to return to U S WEST after changing local service providers, or who choose U S WEST after initially being served by another local service provider. Transmittal No. 965 at p. 32. The Cost Classification Order makes very clear that costs "for the provision of portability" do not include costs incurred as an incidental consequence of number portability. U S WEST has always had to negotiate service orders with its customers, and to obtain customer authorization for a change in service. A customer returning to U S WEST from a competitor will negotiate a service order due date with the expectation that all services, telephone service along with the porting of their number, will occur on the same date and will authorize the change in services, presumably using a Letter of Authorization

(LOA). The provision of LNP does not demonstrably alter this process. U S WEST has failed to demonstrate that such costs are incurred "for the provision of portability," as required by the LNP Cost Classification Order.

Likewise, U S WEST notes that its Service Delivery Costs for CLECs include order writers negotiating a due date with the co-carrier and completing the order. Transmittal No. 965 at p. 21. Negotiating a service order due date, whether with a CLEC or an end customer, is not solely done for the purpose of providing LNP. A CLEC serving a customer may also be ordering additional unbundled elements for the purpose of serving a given customer, and establishing a due date will be part of that process. U S WEST has made no effort to show how the process of providing LNP alters the existing CLEC ordering process, and that any such changes are only for the provision of portability.

If service order negotiation costs are recovered from LNP charges, U S WEST must demonstrate that such costs are not already being recovered from its intrastate non-recurring and recurring charges. In Minnesota, U S WEST has filed a Winback Tariff in which it will waive the non-recurring charge, and up to two months of recurring charges for customers returning to U S WEST from a competitor. (In the Matter of Business, Residence, and Toll Competitive Response Program, Docket No. P421/AM-99-230.) U S WEST should demonstrate that its inclusion of any service negotiation costs for winback customers in its LNP tariff do not result in recovery of costs it has waived in another jurisdiction.

The Commission should prohibit U S WEST's recovery of LNP Service Delivery costs that fail to meet the two-part test required by its Cost Classification. The Commission should deny recovery for costs resulting from U S WEST's failure to provide CLECs with non-discriminatory access to its OSS systems. Requiring end-users to pay for U S WEST's anti-competitive behavior does not further the interest of competition.

Submitted by:

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May 7, 1999

# Exhibit 1

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BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

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|---|---|
| Edward A. Garvey | Chair |
| Joel Jacobs | Commissioner |
| Marshall Johnson | Commissioner |
| LeRoy Koppendrayer | Commissioner |
| Gregory Scott | Commissioner |

In the Matter of a Generic Investigation of US West Communications, Inc.'s Cost of Providing Interconnection and Unbundled Network Elements

In the Matter of Implementing the Geographic Deaveraging Requirements of 47 C.F.R. § 51.507(f)

ISSUE DATE: May 3, 1999

DOCKET NO. P-442, 5321, 3167, 466, 421/CI-96-1540

DOCKET NO. P-999/CI-99-465

ORDER RESOLVING COST METHODOLOGY, REQUIRING COMPLIANCE FILING, AND INITIATING DEAVERAGING PROCEEDING

## PROCEDURAL HISTORY

On February 8, 1996, the President signed into law the Telecommunications Act of 1996 (the Act), Pub. L. 104-104, 110 Stat. 56. The Act's purpose is to provide the benefits of competition to U.S. citizens by opening all telecommunications markets to competition. (Conference Report accompanying S. 652). The Act opens markets in three ways:

> (1) by requiring incumbent local exchange carriers to permit new entrants to purchase their services wholesale and resell them to customers;
>
> (2) by requiring incumbent local exchange carriers to permit competing providers of local service to interconnect with their networks on competitive terms; and
>
> (3) by requiring incumbent local exchange carriers to unbundle the elements of their networks and make them available to competitors on just, reasonable, and nondiscriminatory terms.

47 U.S.C. § 251(c). Under the terms of the Act, a competitive local exchange carrier (CLEC) desiring to provide local exchange service can seek agreements with an incumbent local exchange carrier (ILEC) related to interconnection with the ILEC's network, the purchase of finished services for resale, and the purchase of the incumbent's unbundled network elements (UNEs). 47 U.S.C. §§ 251(c) and 252(a). If the ILEC and the CLEC cannot reach an agreement within the time frame specified in the Act, either party may petition the State commission to arbitrate unresolved issues and to order terms consistent with the Act. 47 U.S.C. § 252(b). In particular, parties may ask the Commission to determine the total element long-run incremental cost (TELRIC) of UNEs, interconnection, and methods of obtaining access to UNEs. 47 C.F.R. §§ 51.501, 51.505.

On December 2, 1996, the Commission issued its ORDER RESOLVING ARBITRATION ISSUES AND INITIATING A US WEST COST PROCEEDING in Docket Nos. P-442, 421/M-96-855, P-5321, 421/M-96-909, and P-3167, 421/M-96-729 (Consolidated Arbitration Proceeding). In that Order the Commission established interim prices for interconnection and unbundled network elements in the territory served by US West Communications, Inc. (US West). The Commission also initiated the present proceeding to establish prices to replace the interim prices.

By its March 12, 1997, NOTICE AND ORDER FOR HEARING, the Commission referred to the Office of Administrative Hearings (OAH) the task of conducting a hearing, developing a record and making recommendations regarding the cost of —

- unbundled network elements,
- unbundling,
- collocation,
- interconnection
- access operational support systems,
- call completion services,
- directory assistance,
- interim number portability,

and related matters. The Commission included geographic deaveraging within the scope of this proceeding.

On November 18, 1998, the Commission received the Report of the Administrative Law Judge (the Report), offering recommendations for resolving the issues in this docket.

On November 25, 1998, the Commission granted US West's request to extend the period to file exceptions to the Report. On December 18, 1998, the Commission received exceptions to the Report from AT&T Communications of the Midwest, Inc. (AT&T), MCI Telecommunications Corporation and MCIMetro Access Transmission Services, Inc. (MCI), the Minnesota Independent Coalition (MIC), the Office of Attorney General's Residential and Small Business Utilities Division (OAG-RUD), and US West. On January 11, 1998, the Commission received replies to the exceptions from AT&T/MCI jointly, the Department of Public Service (the Department), MIC and US West.

The Commission met to consider this matter on March 29-30, 1999.

## FINDINGS AND CONCLUSIONS

### I. Substantive Issues

#### A. Generally

Along with developing a factual record in this case, the Administrative Law Judge (ALJ) offered his recommendations regarding the resolution of a number of factual issues. Those recommendations are summarized below:

1. Use the HAI model to estimate US West's UNE costs, but do not deaverage UNE prices at this time (discussed below).
2. Set the common overhead factor at 13.09%.
3. Set the network support factor at 85%.
4. Set the cost of capital at 9.6%.
5. Allocate loop-related overhead expenses in proportion to the number of loops, rather than in proportion to the amount of investment in loops.
6. Set the depreciation parameters for projection lives and salvage percentages at the values recommended by the Department in its August 15, 1997 Comments in In the Matter of U S WEST Communications, Inc.'s Request for Certification of 1997 Depreciation Rates, Docket No. P421/D-97-891.
7. Use the HAI default regional labor adjustment factor for Minnesota (.99).
8. Adopt the drop lengths and drop placements by density zone set out in Department witness Wes Legursky's testimony.
9. Use the distribution structure mix parameters described by Mr. Legursky and set the fraction available for shifting away from the preassigned structure mix equal to zero.
10. Use the structure sharing parameters described by Mr. Legursky at Ex. 603 at 48-49; Ex. 604, JWL-2, Tables 18-19.
11. Use the buried placement cost parameters described by Mr. Legursky at Ex. 603 at 50; Ex. 604, JWL-2, Tables 20-21.
12. Change the weighted average price for channel units to that recommended by Mr. Legursky at Ex. 603 at 53-54.
13. Adjust the model to allow for dedicated idle lines.
13. Adopt AT&T's methodology for estimating the costs of special access lines on a pair-equivalent basis in the distribution plant and on a circuit-equivalent basis in the feeder plant.
14. Fix the error in calculating the line card costs related to special access lines.
15. Use actual line count data including the special access line count data requested by Department witness Edward Fagerlund and remove the 32 sold exchanges.
16. Reject the SPOT frame proposal and require U S West to provide unbundled network elements in combination as requested by CLECs and to recombine them on behalf of CLECs.
17. Use the MCI/AT&T Collocation Cost Model to estimate collocation costs, but with its overhead factor modified to 13.09%.
18. Deny any US West recovery of operator support system (OSS) costs until US West provides CLECs non-discriminatory access to OSS interfaces and until the Company provides reliable cost support for its proposed rates.
19. Use the MCI/AT&T Non-Recurring Cost Model to estimate non-recurring costs with the following modifications:
    - Use a two percent fallout rate for "plain old telephone service" resale services and a 4.6% fallout rate for complex or designed services;
    - Use an overhead factor of 13.09%; and
    - Account for the cost of customer service assistance with an appropriate fallout rate.

20. Adopt "bill and keep" as the cost recovery methodology for Interim Number Portability.

Having reviewed the record and considered the parties' arguments, the Commission agrees with the ALJ on these matters. Therefore the Commission accepts, adopts and incorporates herein by reference the findings, conclusions and recommendations of the Report.

The Commission will address two of these issues in particular, below.

## B. Choice of Model

The Act and Federal Communications Commission (FCC) rules direct the Commission to establish the least-cost forward-looking long-run incremental cost of various "elements" of a hypothetical telecommunications system having certain characteristics. The parties developed mathematical models to estimate the costs of such a system. US West offered the Regional Loop Cost Analysis Program (RLCAP) model; AT&T/MCI offered the HAI model.

The ALJ found that the RLCAP violated various goals of a TELRIC model. Report at ¶¶ 33-45. For example, it relies on US West embedded costs and other historic data and practices, contrary to the Telecommunications Act's "forward-looking" objective. Id. at ¶¶ 16, 43. Also, the record does not support the data and assumptions underlying the model. Id. at ¶¶ 18-26. For example, the ALJ characterizes US West's inputs to its Switching Cost Model as "unknown, undocumented and proprietary." Id. at 82. RLCAP fails to reflect certain Minnesota-specific circumstances, such as terrain. Also, the RLCAP is not well integrated with other US West models, making the model administratively burdensome, id. at ¶ 17, and facilitating errors, id. at ¶ 40.

In contrast, the HAI model better reflects TELRIC principles. It also incorporates more Minnesota-specific data. For example, it incorporates Minnesota-specific ground conditions. Report at ¶¶ 74-76. More significantly, it uses Minnesota-specific customer location data. Id. at ¶ 48. The distribution portion of a telephone network constitutes a major component of the total network costs. Assumptions about customer locations influence distribution designs, which influence distribution costs, which heavily influence the total network costs. While this location data is not complete, and the method for estimating locations for unaccounted-for customers is imperfect, there is reason to believe that more location data, and better data, will become available in time. Id. at ¶¶ 49-51. In any event, even using the current data and location estimator algorithms, the HAI model is superior to any alternative in the record.

Having reviewed the record in this proceeding, the Commission finds that the Report's analysis identified the appropriate features of the models for analysis, and gave a fair assessment of the record evidence on those features. The Commission adopts the ALJ's recommendation on this point.

## C. Geographic Deaveraging

### 1. Background

The cost of providing some elements of telecommunications service may vary from place to place, especially between urban and rural places. Calculating the cost of an element without addressing cost differences between locations effectively produces an average cost for that element. Generating different costs for an element depending upon where the element is offered produces deaveraged costs.

The Act prescribes that rates for interconnection and unbundled network elements be "based on the cost ... of providing the interconnection of network elements." 47 U.S.C. § 252(d)(1)(a)(i). The FCC concluded that geographically deaveraged rates more closely reflect the actual cost of providing interconnection and unbundled elements than do averaged rates. In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, 11 FCC Rcd 15499 (August 8, 1996) (First Report & Order) ¶¶ 764-65. Therefore, the FCC adopted 47 C.F.R. § 51.507(f) which directs state commissions to "establish different rates for [unbundled network] elements in at least three defined geographic areas within the state to reflect cost differences." In 1996, however, the federal Eighth Circuit Court of Appeals found probable grounds to believe that the FCC lacked the authority to adopt pricing rules, including § 51.507(f), and stayed the rules' effect. Iowa Utilities Bd. v. FCC, 96 F.3d 1116 (8th Cir.), motions to vacate stay denied, 117 S. Ct. 378, 379, 429 (1996).

This entire docket ensued thereafter. While the Commission directed that the parties consider geographic deaveraging, it emphasized that the Commission would retain discretion over how to act on the information. NOTICE AND ORDER FOR HEARING at 3. Perhaps as a result of the Eighth Circuit's stay and subsequent holding in Iowa Utilities Board v. FCC, 120 F. 3d 753 (1997), the parties' discussion of geographic deaveraging remained at a general level. Only AT&T/MCI proposed an implementation plan identifying zone boundaries for calculating rates. The Department, OAG-RUD, US West, and ultimately the ALJ each concluded that the Commission should refrain from deaveraging rates, at least in the context of this docket. Report at ¶¶ 131-32.

Shortly before the Commission considered this matter, the U.S. Supreme Court reversed the Eighth Circuit decision regarding § 51.507(f), among other matters, and remanded the case for further proceedings. AT&T Corp. v. Iowa Util. Bd., __ U.S. __, 119 S.Ct. 721 (January 25, 1999). No party to this docket had the opportunity to brief the Commission on the impact of the Supreme Court's decision. And the issue of specifically *how* to implement § 51.507(f) came before the Commission briefed only by AT&T/MCI.

### 2. Positions of the Parties

AT&T/MCI argue that the Commission must approve deaveraged rates. They note that —

- Now that the Supreme Court has reversed the Eighth Circuit's decision staying implementation of § 51.507(f), that rule is now the law of the land. The Commission lacks the discretion to refrain from implementing deaveraging.

- Delaying deaveraging harms competition and competitors.

Notwithstanding the Supreme Court reversal of the Eighth Circuit's decision regarding § 51.507(f), however, the Department, MIC, OAG-RUD and US West continue to oppose adopting deaveraged rates in this proceeding. They argue that —

- The import of § 51.507(f) remains in flux. The Supreme Court remanded consideration of the FCC's rules to the Eighth Circuit, which may yet find other grounds to suspend § 51.507(f).

- The terms of § 51.507(f) do not mandate any specific time for implementation. At least two federal district courts have upheld state commission decisions that refrained from deaveraging UNE rates immediately, in spite of the Supreme Court's decision.[1] Also, in a speech before state utility regulators, FCC Chairman William Kennard indicated an intent to "grant a temporary extension [for implementing deaveraging] to coordinate our efforts".[2]

- Immediate deaveraging of UNEs could have undesirable consequences. See Report at ¶¶ 131-32. The cost of rural UNEs would rise while urban UNEs would fall. Assuming that the incumbent's retail rates did not change, rural competitors would have difficulty using high-cost rural UNEs to compete with an incumbent's lower averaged retail prices.

  Alternatively, urban competitors using low-cost UNEs could create pressures for the incumbent to deaverage its retail rates. While that would let the incumbent offer lower rates in urban areas, rural customers would likely experience increased rates from the incumbent, resale-based competitors, and UNE-based competitors alike. This would frustrate the public policy goal of ensuring that a telephone company's retail rates are generally uniform, Minn. Stat. § 237.09, and that people —

  > in rural, insular, and high cost areas, should have access to telecommunications and information services ... that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates changed for similar services in urban areas.

  47 U.S.C. § 254(b)(3).

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[1]MCI Telecommunications Corp. v. BellSouth Telecommunications, Inc., __ F.Supp. 2d __, WL 166183 (E.D.Ky, March 11, 1999) (Kentucky case); MCI Telecommunications Corp. v. GTE Northwest, Inc., __ F.Supp. 2d __, 1999 WL 151039 (D.Or., March 17, 1999) (Oregon case). In each case, the Eighth Circuit's stay of 47 C.F.R. § 51.507(f) was in effect at the time the commission approved averaged rates; notwithstanding the Supreme Court's subsequent reversal of the Eighth Circuit, the district courts upheld the commissions' decisions.

[2]From the speech "Moving On" on February 23, 1999, at the National Association of Regulatory Utility Commissions (NARUC) Winter Meeting, Washington, D.C.; prepared text available from the FCC, or from the FCC's World Wide Web internet site at http://www.fcc.gov/commissioners/kennard/speeches.html.

This outcome is all the more unfortunate because it can arguably be avoided. Both federal and state law provide for a universal service fund to help offset such rate increases (47 U.S.C. § 254; Minn. Stat. § 237.16, subd. 9), but each fund remains in some stage of development.[3]

- The terms of § 51.507(f) require deaveraging into "at least three defined geographic areas *within the state*" (emphasis added). This language suggests that a state-wide analysis, rather than a company-specific analysis, is necessary. Such an analysis cannot be accomplished in a docket dedicated to the analysis of a single telephone company, US West.

### 3. Commission Action

The Commission recognizes that whether or not to permit rates to reflect differences in the cost of serving different geographic areas has always been a public policy issue of the highest order. The Commission has traditionally averaged the costs of serving different geographic areas when setting rates. Allowing rates to reflect cost may work to the detriment of rural communities, increasing the price of services reaching homes and businesses there and impeding economic development. The decision to open the local telecommunications market to competition, however, introduces new factors into the public interest equation. It has been argued that the fastest and surest route to robust, statewide competition is through opening high-density, low-cost areas to competition first by deaveraging the price of UNEs; universal service funds will offset any threatened harms to low-density, high-cost areas.

The importance and complexity of these issues can scarcely be overstated. A matter of this consequence warrants exploration and development in its own docket. On the basis of the current record, the Commission concludes that the orderly evolution of competition and pro-competitive regulation favors implementing deaveraging only after a more thorough analysis.

The need to implement deaveraging in a coordinated fashion is recognized by FCC Chairman Kennard, other states, and the courts. The Federal District Court in Oregon, for example, found it reasonable to defer deaveraging to allow an orderly, deliberate approach:

> MCI contends the [Oregon Public Utilities Commission, or PUC] erred by establishing a single state-wide interim loop price, instead of "deaveraging" those prices into multiple zones (based on density or some other criteria) and charging a different price for each zone. The net affect of MCI's proposal would be to reduce loop prices in dense urban areas, while significantly increasing loop prices in the rest of Oregon....

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[3]See generally In the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45 (federal docket); In the Matter of the Planned Promulgation of Rules Governing the Competitive Provision of Local Telephone Service, including issues related to Universal Service, Regulatory Treatment of Competitive Local Exchange Carriers (CLECs), Service Quality, and Emergency Service (911), Docket No. P-999/R-97-609 (state docket).

> This court declined to order immediate deaveraging in two prior decisions. [Citations omitted.] This court concluded that ... "[t]he PUC has not refused to deaverage loop prices, but wants to do it in an orderly fashion" and planned to address deaveraging in a separate proceeding. [Citation omitted.] Finally, the court acknowledged concerns, voiced by both U.S. West and the PUC, that the deaveraging of loop prices needs to be coordinated with the deaveraging of retail prices for those services and the implementation of explicit universal service programs, which was lagging....
>
> The court also observes that the Oregon PUC was aggressively moving toward implementing unbundled elements and local competition long before Congress passed the Act. This is not a case where the PUC has had to be forced into embracing local competition. Accordingly, when the Oregon PUC concludes that deaveraging in Oregon is premature, or it does not have the information it needs to implement deaveraging in an orderly manner, this court is inclined to give considerable deference to the PUC's opinion.[4]

Similarly, as Federal District Court in Kentucky explained,

> [T]he [Kentucky Public Service Commission, or PSC] states that it carefully balanced universal service goals with the Act's mandate of fostering the rapid development of competition when establishing the cost-based UNE rates. It defends its decision not to deaverage at this early stage of competition by relying on the need to serve all customers and the fact that the Act explicitly provides that a company's rates to subscribers in rural and high cost areas may be no higher than its rates charged to urban subscribers. See 47 U.S.C. § 254(g). The PSC does not dispute the fact that deaveraging will occur in the future; however, such action is not feasible at this point in time....
>
> The PSC must remain focused on the long term interests of the citizens of Kentucky. Therefore, the decision of the PSC to balance universal service goals with the purpose of the Act by refusing to deaverage UNE rates was lawful.[5]

For the foregoing reasons, the Commission will not order deaveraging in this docket. Rather, the Commission will establish a state-wide docket for the immediate exploration of geographic deaveraging and the implementation of 47 C.F.R. § 51.507(f). The Commission will begin this effort by inviting comment, on both substance and process, from all interested entities. In particular, the Commission is interested on how best to make use of the record developed in the current docket.

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[4] Oregon case at 12-13.

[5] Kentucky case at 6.

## II. Procedural Issues

### A. Compliance Filing

The Report did not include the calculations necessary to translate the ALJ's recommendations into final rates. Those calculations require the participation of the parties. The Commission will therefore follow the Department's recommendation and direct the parties to make a compliance filing setting forth the final rates resulting from the Report adopted herein.

### B. Continuing Jurisdiction

The rate decisions made in this docket are both fact-intensive and critical to the future of telecommunications competition in Minnesota. Any significant change in the facts on which these decisions are based will probably require a change in rates. For example, US West is seeking to sell some of its high-cost exchanges. As long as rates reflect geographically-averaged costs, the loss of a high-cost exchange has the potential to change the TELRIC for elements in the remaining exchanges.

The public interest clearly requires that the Commission retain jurisdiction over this docket. The Commission will do so.

### C. Geographic Deaveraging

As noted above, the Commission will establish a state-wide docket to determine how to implement 47 C.F.R. § 51.507(f), which directs states to deaverage UNE prices into "at least three defined geographic areas within the state."

## ORDER

1. The Commission adopts the findings, conclusions and recommendations of the Report of the Administrative Law Judge.

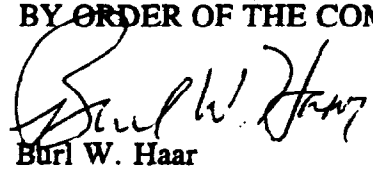
2. The parties shall make a compliance filing within 30 days of the effective date of this Order sufficient to permit a determination that the recommendations in the Report of the Administrative Law Judge were implemented, and setting forth the resulting rates.

3. The Commission retains jurisdiction over this matter.

4. The Commission establishes a state-wide docket, Docket No. P-999/CI-99-465 In the Matter of Implementing the Geographic Deaveraging Requirements of 47 C.F.R. § 51.507(f), for the purpose of exploring geographic deaveraging and implementing 47 C.F.R. § 51.507(f). Interested entities shall file comments within 60 days of the effective date of this Order addressing the matters to be addressed and the procedure to be followed, and how to best use the information collected in the current docket.

5. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION



Burl W. Haar
Executive Secretary

(S E A L)

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STATE OF MINNESOTA )
) ss
COUNTY OF RAMSEY )

AFFIDAVIT OF SERVICE

I, **Linda Chavez**, being first duly sworn, deposes and says:

That on the **7th** day of **May**, **1999**, she served the attached **Comments of the Minnesota Department of Public Service on Direct Case**

Docket Numbers: **CC Docket No. 99-35**

X by depositing in the United States Mail at the City of St. Paul, a true and correct copy thereof, properly enveloped with postage prepaid.

X by personal service

X by express mail

by delivery service

to all persons at the addresses indicated below or on the attached list:

Linda Chavez

Subscribed and sworn to before me

this 7 day of May, 1999

Robin Benson

ROBIN J. BENSON
NOTARY PUBLIC - MINNESOTA
My Comm. Exp. Jan. 31, 2000

**CC Docket No. 99-35**

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